Manager's Commentary

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Market Environment

As we begin 2026, US equity markets appear to be at an inflection point. 2025 was shaped by a resilient economy, evolving policy dynamics, and rapid technological innovation, offset against elevated valuations and geopolitical uncertainty. The bull market that began in late 2022 is now entering its fourth year, during which large-cap equities have delivered strong returns, with the S&P 500 posting a three-year annualized return of ~23%. By comparison, small and mid-cap stocks have lagged, with the S&P SmallCap 600 and S&P MidCap 400 generating annualized returns of 10.2% and 12.5%, respectively.

As a result of this divergence, small-cap valuations remain reasonable, and the case for mean reversion relative to large-caps remains compelling. Small-caps have also only recently emerged from an earnings recession that lasted more than two years as profit margins normalized from the Covid-19 era bump. Looking ahead, the return to earnings growth—particularly growth expected to outpace large-caps—could be a key catalyst for sustained outperformance in 2026.

Against this backdrop, we remain constructively bullish on the US small and mid-cap opportunity set. Market leadership has become increasingly concentrated. The top 10 stocks now represent approximately 39% of the S&P 500, compared with just 7.3% in the S&P MidCap 400 and 5.5% in the S&P SmallCap 600, leaving the large-cap market more vulnerable to volatility should sentiment or fundamentals shift. While AI remains a powerful secular theme, its growing share of market capitalization reinforces the importance of active stock selection, particularly as capital intensity rises and valuation dispersion widens.

	Trailing annualized returns		Valuation	
	3-year	**5-year**	**Fwd P/E**	**FCF Yield**
S&P 500	23%	14%	22.4x	2.6%
S&P 400 Mid Cap Index	13%	9%	16.2x	4.1%
S&P Small Cap 600	10%	7%	15.1x	5.9%

More recently, market action has been encouraging for value-oriented stocks and smaller companies, with the S&P 600 rebounding ~10% late in the year, compared with a 3.5% gain for the S&P 500. Declining interest rates are also supportive, as smaller companies tend to carry more floating-rate debt, providing a meaningful tailwind to earnings as financing costs fall.

Looking ahead, we do not believe these improving fundamentals are fully reflected in valuations. Small caps continue to trade at meaningful discounts, with the S&P 600 at just over 15x forward earnings, roughly 30% below the S&P 500—a gap that remains wider than its long-term average. In our view, this suggests limited downside valuation risk, while stronger earnings growth could support relative outperformance.

The takeaway as we look ahead to 2026 is that the environment appears increasingly supportive for high-quality small and mid-cap businesses. With valuations still attractive, earnings leverage improving, and market leadership beginning to broaden, we see compelling opportunities for patient investors. At Pender, we remain focused on owning businesses, not trading stocks, and on identifying mispriced companies where fundamentals—not narratives—drive long-term value creation.

Fund Specific Updates

Index / Fund	December Return	1 Year Return
Pender US Small/Mid Cap Equity Fund (CAD)	**2.0%**	**12.7%[1]**
S&P 400 Mid Cap Index (CAD)	-1.6%	2.5%
Peer Group (CAD) Source: Morningstar	-1.83%	1.79%

- 2025 ended on a positive note with **DigitalBridge Group Inc. (DBRG)** receiving an acquisition offer on Dec 29 from Softbank Group at $16 per share, a 50% premium to the unaffected 52-week average closing price as of December 4. **Deckers Outdoor Corp. (DECK)** and **Microchip Technology Incorporated (MCHP)** were also key contributors for the month.
- For the year, **Ero Copper Corp. (ERO)** was the top contributor helped by a 40% increase in the price of copper. The company also commissioned a new mine that will contribute to >80% YoY increase in copper production at the midpoint of 2025 guidance. **Rambus Inc. (RMBS)** and **Dollar Tree Inc. (DLTR)** were also key contributors for the year.

We initiated a position in **FactSet Research Systems Inc. (FDS)** during the month. FactSet is a leading financial data and software company providing global market data, analytics, and research tools for investment professionals. Over the past four years, the company has compounded adjusted EPS at approximately an 11% CAGR, while maintaining returns on invested capital above 20%, underscoring the strength of its business model.

Recently, the stock has traded under a cloud as investors weigh the potential for AI-led disruption across the information services landscape. In our view, these concerns overlook the embedded nature of FactSet's offering within its clients' day-to-day workflows. FactSet's value lies not just in data aggregation, but in its deep integration into customer-specific processes, proprietary datasets, analytical tools, and customized models that are difficult to replicate or displace.

We believe AI represents more of an opportunity than a threat for FactSet. The company's domain expertise and long-standing client relationships position it well to incorporate AI capabilities in ways that enhance productivity, improve decision-making, and reinforce switching costs. This dynamic supports the durability of FactSet's competitive moat and its ability to continue compounding value over time.

From a portfolio perspective, FactSet aligns well with our philosophy of owning businesses, not trading stocks. We view the recent pullback as an opportunity to add a proven compounder at a more attractive valuation, supported by recurring revenues, strong cash flows, and disciplined capital allocation.

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January 12, 2026

[1] *All Pender performance data points are for Class F of the Fund. Other classes are available. Fees and performance may differ in those other classes. Standard Performance Information for Pender's Equity Funds may be found here: https://penderfund.com/fund/pender-us-small-mid-cap-equity-fund/.*